



STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS

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| Date Introduced | 2/21/02 | Bill No: | SCA 9 |
| Tax: | Property | Author: | Speier |
| Board Position: | Support | Related Bills: | |

BILL SUMMARY

This bill would place a constitutional amendment before voters to create a change in ownership exclusion, upon the death, or prior to death in the case of a terminal illness or disease, for persons who co-own and co-habitate a home.

ANALYSIS

Current Law

Under existing property tax law, real property is reassessed to its current fair market value whenever there is a "change in ownership." (*Article XIII A, Sec. 2; Revenue and Taxation Code Sections 60 - 69.7*)

Under current law, a transfer of property between co-owners who are not spouses or former spouses is generally considered a change in ownership triggering reassessment of that property.

Proposed Law

If enacted and approved by voters at the next election, this bill would amend subdivision (g) of Section 2 of the California Constitution to provide that the terms "purchased" and "change in ownership" do not include the purchase or transfer of the principal residence of a transferor to a cohabitant of that personal residence, if all of the following requirements are satisfied:

- **Co-ownership.** The personal residence was coowned by the transferor and the transferee for the five-year period immediately preceding the transfer.
- **Residence.** The transferor and the transferee continuously resided as cohabitants of the residence for the five-year period immediately preceding the transfer.
- **Death or Terminal Illness.** The transfer is made under either of the following circumstances:
 - Because the transferor died.
 - The transferor has been certified in writing by a licensed physician and surgeon to have a terminal illness or terminal disease. "Terminal illness" or "terminal disease" is defined to mean a medical condition resulting in a prognosis of life of two years or less if the disease follows its natural course.

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In General

Property Tax System. California's system of property taxation under Article XIII A of the State Constitution (Proposition 13) values property at its 1975 fair market value, with annual increases limited to the inflation rate, as measured by the California Consumer Price Index, or 2%, whichever is less, until the property changes ownership or is newly constructed. At the time of the ownership change or new construction, the value of the property for property tax purposes is redetermined based on current market value. The value initially established, or redetermined where appropriate, is referred to as the "base year value." Thereafter, the base year value is subject to annual increases for inflation. This value is referred to as the "factored base year value."

Change in Ownership. While Proposition 13 provided that a "change in ownership" would trigger reassessment, the phrase was not defined. The Assembly Revenue and Taxation Committee appointed a special task force to recommend the statutory implementation for Proposition 13 including its change in ownership provisions. The task force findings are published in California State Assembly Publication 723, Report of the Task Force on Property Tax Administration, January 22, 1979. A second report "Implementation of Proposition 13, Volume 1, Property Tax Assessment," prepared by the Assembly Revenue and Taxation Committee, California State Assembly Publication 748, October 29, 1979, provides additional information on how changes in ownership would be determined under Proposition 13.

Background

Change in Ownership Exclusions. As previously stated the phrase "change in ownership" was not defined by the original Proposition 13 amendment. Certain definitional "exclusions," including the interspousal exclusion, were embodied in the initial statutory definitions necessary to implement Proposition 13's change in ownership provisions. Thereafter, three other exclusions were statutorily provided as noted below.

| Bills | Year | Change In Ownership Exclusion | R&T Code |
|---------|----------------|--|--------------|
| AB 1488 | 1979, Ch. 242 | Interspousal Transfers – including marriage dissolutions (subsequently amended into Constitution via Prop. 58) | §63 |
| AB 2718 | 1982, Ch. 911 | Parent to Minor Child Upon Death of Parent-Residence | §62(m) |
| AB 2890 | 1984, Ch. 1010 | Parent to Disabled Child - Residence | §62(n) |
| AB 2240 | 1984, Ch. 1692 | Purchases of Mobilehome Parks by Residents ¹ | §62.1, §62.2 |

¹ Questions have surrounded the constitutionality of this exclusion because it was created by statute. As a result a Legislative Counsel opinion was requested. Legislative Counsel's Opinion #6691, issued May 18, 1992, opined that the exclusion from change in ownership of mobilehome parks converted to resident-ownership from change in ownership was not a valid interpretation of that term as it is used in Article XIII A of the California Constitution, and was not authorized by any constitutional provision allowing mobilehome parks preferential treatment in avoiding reappraisal. Although it has been stated that an amendment would be sought, to date, no constitutional amendment has been enacted for this exclusion.

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Since Proposition 13, the constitution has been amended twice to provide for additional change in ownership exclusions. These transfers will not trigger a reassessment of the property to current fair market value. Instead, the property will retain the prior owner's base year value

| Prop. | Election | Change In Ownership Exclusion | R&T Code |
|--------------|-----------------|---|---------------------|
| 58 | Nov. 6, 1986 | Parent-Child Interspousal- statutorily provided since 1979 | §63, §63.1 |
| 193 | March 26, 1986 | Grandparent–Grandchild | §63.1 |

Other constitutional amendments have been approved by voters permitting a person to “transfer” their Proposition 13 base year value from one property to another property, thereby avoiding reappraisal of the newly acquired property to its fair market value. In essence, this is another form of a change in ownership exclusion. Those constitutional amendments include:

| Prop. | Election | Base Year Value Transfers | R&T Code |
|--------------|-----------------|---|---------------------|
| 3 | June 8, 1982 | Replacement Property After Government Acquisition | §68 |
| 50 | June 3, 1986 | Replacement Property After Disaster | §69 |
| 60 | Nov. 6, 1986 | Persons Over 55 - Intracounty | §69.5 |
| 90 | Nov. 8, 1988 | Persons Over 55 - Intercounty | §69.5 |
| 110 | June 5, 1990 | Disabled Persons | §69.5 |
| 1 | Nov. 3, 1998 | Contaminated Property | §69.4 |

Other legislation previously before the Legislature, but not enacted, to exclude certain transfers from change in ownership, either through constitutional amendment or statutory amendment, include:

| Bills | Year | Change in Ownership Exclusion |
|--------------|-------------|---|
| AB 1419 | 1981 | Transfers between family members – spouse, brother, sister, lineal ancestor, or lineal issue. |
| ACA 8 | 1987 | Transfers of principal place of residence between siblings who live together two years prior. |
| ACA 55 | 1988 | Transfers of principal place of residence between siblings who live together two years prior. |

Additionally, a “Save Proposition 13” constitutional initiative amendment sponsored by Howard Jarvis in 1984, would have, among other things, excluded certain family transfers from change in ownership. That proposition failed with voters.

| Prop. | Election | Change in Ownership Exclusion |
|--------------|-------------------------------|--|
| 36 | Nov. 6, 1984 45.2% - 54.8% | Transfers from the owner to parents, grandparents, grandchildren, stepparents, uncles, aunts, spouses, stepchildren, siblings, and lineal descendants. |

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COMMENTS

1. **Sponsor and Purpose.** This bill is sponsored by the author to place a constitutional amendment on the ballot to create a change in ownership exclusion for cohabitants of principal places of residence. With the amendment, after the death of the co-owner, the Proposition 13 protected value of property would be preserved. The surviving co-owner would continue to pay the same amount of property taxes on the property.
2. **Generally, transfers of real property between co-owners with equal ownership in the property are subject to either a 50% or 100% reappraisal to fair market value as of the date of the transfer (typically the date of death).** The percentage of the property subject to reappraisal depends upon how the property was held and the manner in which the co-owner was added to the title of the home. For instance, a 100% reappraisal would occur where the surviving co-owner was added to the title at a later date in a joint tenancy form of ownership. Whereas if both co-owners came on title at the same time as tenants in common, a 50% reappraisal would occur.
3. **Reassessment of property to current fair market values can result in sharp increases in property taxes.** A fundamental argument for Proposition 13 was that a person would thereafter not be “taxed” out of their home because of increasing property taxes.
4. **The proposed change in ownership exclusion could apply to any number of living situations.** For example, seniors, veterans, or others who choose not to marry because of the loss of various benefits; persons who choose not to marry for other reasons or may be unable to marry legally; same sex relationships; domestic partnerships; persons with familial relationships, such as siblings or other relations; friends or companions; care providers and care-takees; or persons who live together to share the cost of housing. The only requirement is that:
 - The home be co-owned for at least five years prior to the transfer,
 - The persons reside together in the home for the five years prior to the transfer, and
 - The home will be left to the surviving co-owner upon death – in the case of death presumably this would occur via a joint tenancy form of ownership, a will, trust, or life estate granting the home to the other co-owner, or by reason of the laws of intestate succession.
5. **The exclusion would only apply to a principal place of residence.** With respect to transfers of other types of real property (i.e. rental or income producing property), such transfers of property between co-owners would still be subject to reassessment.

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6. **The exclusion would only apply to transfers of residences resulting from a death or terminal illness.** Other transfers of property between co-owners at other points in time would still result in reassessment of the property.
7. **As the element of Proposition 13 requiring property to be reassessed upon “change in ownership” is triggered, those affected have sought legislation and constitutional amendments based on the rationale that the tax system unfairly penalizes them.**
 - That property, business, or farms that “stay in the family” should not be subject to a property tax increase, possibly requiring the property to be sold if the child can’t afford the property taxes.
 - That older persons should be able to “downsize” and pay the same amount of property taxes.
 - That persons who may need to move residences because of a disability should be able to pay the same amount of property taxes.
 - That persons who were displaced from their home or property through no fault of their own should be protected from increased property taxes.
 - That persons buying the land underneath their mobilehome where they reside should be able to pay the same level of property taxes as the prior owner.
8. **This constitutional amendment is prospective; therefore it only applies to transfers occurring on or after November 6, 2002.** This constitutional amendment is not retroactive or retrospective as currently drafted. It would therefore only apply to transfers between co-owners **first** occurring on or after November 6, 2002 if enacted by voters. Any transfers occurring prior to this date, such as contacts from constituents to the author’s office inspiring this legislation due to a reassessment of property, would not be affected (i.e. the reappraisal would not be reversed, either prospectively or retroactively). As currently drafted, the November 6, 2002 date would be embedded in the constitution, requiring another constitutional amendment to change its application with respect to retroactivity or retrospective application. Consequently, if enacted, similarly situated taxpayers who had a transfer occurring prior to November 6, 2002 may mistakenly believe that the constitutional amendment will reverse the reappraisal of their property, leading to disappointment and eventual requests for another constitutional amendment. If prospective application is not the author’s intent, then clarity on the retroactive/prospective/retrospective application of the bill and explicit language that matches that intent will avoid future frustration and conflict for all parties involved.

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COST ESTIMATE

If the voters of California adopt this constitutional amendment, the Board would incur some minor absorbable costs in informing local county assessors, the public, and staff of the law changes.

REVENUE ESTIMATE

Background, Methodology, and Assumptions

Current property tax law excludes certain transfers of real property between parties from classification as a "change of ownership" requiring reappraisal of the subject property for tax purposes. Most notably, this would be for transfers of property between spouses or former spouses. In addition, the purchase or transfer of principal places of residence or the first million dollars of all other property (1) between parents and children or (2) between a grandparent to a grandchild whose parents are deceased is excluded from "change of ownership".

Under this bill, the transfer of principal places of residence between other cohabitants would be excluded from classification as a "change of ownership" under the conditions specified above.

It is impossible to estimate the revenue effect with any degree of certainty due to the lack of predictability of the factors involved, including which properties would be affected, their assessed value and their market value at the time of transfer, the form of ownership, and the length of ownership and tenancy.

Under the current change in ownership rules, in some instances, a 100 percent reappraisal could occur upon the transfer of ownership between coowners when there are only two owners in joint tenancy. On the other hand, if the property were held by two owners as tenancy in common, this type of transfer would result in a 50 percent reappraisal.

Based on reports from county assessors, there were over 5.2 million properties receiving the homeowners' exemption in 2000. The total assessed value of these properties is estimated to be \$921 billion. The average assessed value of properties receiving the homeowners' exemption in 2000 was \$176,000. The median home price in December 2001, according to the California Association of Realtors, was \$285,000. The maximum total amount of affected value can be estimated as $[\$285,000 - \$176,000] \times 5.2$ million, or \$566.8 billion. Making an adjustment assuming that they are held in tenancy in common, the potential total amount of affected value is then \$566.8 billion x 50 percent, or \$283.4 billion. The revenue impact at the basic one percent property tax rate is \$283.4 billion x 1 percent, or \$2.83 billion.

This figure is the maximum amount of property tax revenue loss that could be expected from this proposal. It is clear that the actual amount would be significantly less than this, as not all of the property included in the above analysis would be subject to the provisions of this bill, but how much less is impossible to determine.

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Revenue Summary

It is not possible to determine the revenue impact of this proposal as the information regarding the number of properties affected, the current assessed value and the actual market value of these properties, the form of ownership, the length of ownership and tenancy, and the spousal and familial relationship of coowners/cohabitants is not available. The analysis presented above is an attempt to estimate the order of magnitude of potential revenue loss of this proposal.

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